WHAT IT IS

WHAT IT'S WORTH

The VAR Initiative

A framework for Neighborhood Economic Revitalization

The Village Network
Neighborhood Revitalization from Within

8708 S. Bennett Ave, Ste 123
Chicago, IL 60617
LiveNChicago@gmail.com
www.villagenetwork.org
(773) 426-2896

"VAR is indeed intriguing and especially interesting because it brings into the mix resources that are now constrained in their ability to be put to use for neighborhood revitalization."

- Julia Stasch, President,
John D. and Catherine T. MacArthur Foundation

Introduction

Since the real estate market crash of 2008, low property values continue to plague underserved neighborhoods in many markets across the U.S., despite substantial recovery in more established neighborhoods. Millions of home owners have little to no equity, or still owe more than their property is worth.[1]

These homeowners are stuck and unable to sell or use their home equity to address needed improvements or repairs—adding to the number of aging housing stock in disrepair, often with costly inefficiencies and health and safety hazards, considering that over 40% of homes were built prior to 1969.[2]

Property Values

It is important to understand that a property's appraised value is determined by the sale of comparable properties (comparables). The rule is that a comparable must be a sale, per the "sales" rule. This rule is a guideline set by Fannie Mae, FHA/HUD, and the like. More specifically, comparables must be within a radius (typically one mile) and be comparable in size, condition, number of bedrooms and baths, etc. ***It is very important to note that comparables have a shelf life, expiring within 12 months from the date of closing.***

Comparables are like the fuel that keeps the property value "engine" moving. However, if there is not a healthy amount of new sales, an area can literally run low or out of gas. Without useable comparables, mortgage lenders cannot approve loans. If consumers cannot obtain mortgages, the market in that area stalls. Investors are forced to buy and hold because they cannot sell, and the downward spiral continues. This phenomenon is rampant in many underserved areas across the U.S.

A Partial Solution

Neighborhood Stabilization Programs (NSP) is designed to stabilize neighborhoods that have been hard hit by foreclosures and abandonment.[3] The NSP provides grants to every state, in certain local communities, through delegate organizations to purchase foreclosed or abandoned homes and to rehabilitate, resell, or redevelop these homes in order to stabilize neighborhoods and stem the decline of values of neighboring homes. The program is authorized under Title III of the Housing and Economic Recovery Act of 2008. NSP is, by default, a higher value comp creator. Still, even NSP does not have the funds to solely revitalize entire neighborhoods.

Many municipalities and non-profits have taken on similar strategies. They acquire distressed properties either at significantly reduced prices or mostly donated from local land banks or

[1] http://www.realtytrac.com/news/realtytrac-reports/q3-2015-u-s-underwater-home-equity-report/
[2] http://eyeonhousing.org/2015/08/the-aging-housing-stock-2/
[3] https://www.hudexchange.info/programs/nsp/

mortgage note holders. These properties are then renovated and sold to low-to-moderate-income buyers. These sales also represent higher-value comparables.

Real estate investors purchase distressed properties one at a time or in bulk from mortgage note holders. When they renovate and sell the property, they produce the higher value comparable. Real estate investors are the primary source of higher value comparables and currently the primary driver of market recovery in distressed neighborhoods.

Bridging the Gap - Consumer Renovation Programs (CRPs)

Another seldom considered option exits. Consumer renovation programs (CRPs) such as HUD's FHA 203(k) and Fannie Mae Homestyle® and the like, were designed as solutions that allow owner-occupying buyers and existing homeowners to tap into higher value comparables, such as those created by real estate investor flips, NSP and others. These programs are unique in the following ways.

1. The real estate appraiser is allowed the exception to appraise the property—NOT for its *current* value, but for the *value after renovation* (VAR). *It is important to note that this rule/underwriting guideline exception, set by Fannie Mae & HUD/FHA, is the ONLY one of its kind in the entire mortgage lending industry.*
2. Funds in a single loan are used to not only purchase or refinance, but to renovate.
3. Two contractors are required—one to do the work, and the other (renovation consultant) to make sure the work is done correctly.
    - The renovation consultant provides the consumer a report with all the labor and material needed to do the renovation called a specification of repairs (SOR).
    - The renovation consultant sees project to the end, signing off on any work completed before contractor is paid.

The Challenges: Consumer Awareness, Guideline Update

Consumer Awareness—Though CRPs have existed for decades, they are virtually *unknown* to the general public. Professionals in real estate and related industries have very limited familiarity and little to no experience with CRPs. These loans are more complex, but very profitable for mortgage lenders, many of which have entire departments dedicated to renovation. Lack of consumer awareness of the existence of CRPs is widespread.

Guideline Update—The current underwriting guidelines for CRPs as set forth by Fannie Mae and HUD (FHA) state that a comparable must be a sale per the "Sales" Rule.[4] The appraised VAR is *technically* not a "sale." In the case of an existing homeowner who would refinance into at CRP, there is no "sale" and the improved value is most often not filed to public record, and in the case of a consumer purchase, the property was acquired for a lessor amount (likely distressed). That lessor amount is what is recorded as the sale and becomes the comparable value, *despite* substantial material improvements to the property.

[4] https://www.fanniemae.com/content/guide/selling/b4/1.3/08.html
http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/handbooks/hsgh/4150.2

The appraised VAR is NOT recorded on the Multiple Listing Service (MLS) and thereby excluded as a comparable, simply because that improved value does not represent a "sale," even though:

- CRPs, by design, increase a property's actual value due to the tangible improvements to the property, e.g., new or extra bathrooms, bedrooms, updated kitchen, home addition, etc.;
- The lender funds the mortgage loan based on the appraised VAR;
- FHA and HUD loans are insured based on the appraised VAR;
- The new title is issued based on the appraised VAR;
- The consumer closes on a new mortgage based on that appraised VAR; and notably,
- A ***sale***, is defined as "the exchange of goods, services, or property for money."[5] Thereby, the CRP, by definition, per Miriam-Webster, is in fact, a "sale."

Inefficaciously, when a CRP loan closes, the appraised VAR is discarded as a usable comparable because it is not, *categorically*, a "sale." This dated practice begs a question. Should VAR, in the case of a CRP and for the purposes of comparables, be the exception to the "sales" rule? The example below further clarifies.

Sample Case: (approximate numbers are used for clarification purposes only)
An owner-occupying consumer (non-investor) purchases a distressed property ***"Property A,"*** *for $50,000 using the CRP, FHA 203(k). The CRP is a single loan to purchase and renovate. This buyer is approved for $250,000, so if they purchase for $50,000 they will have up to $200,000 allowed for renovation. The buyer hires a Renovation Consultant who provided a Specification of Repairs (SOR) for $200,000 to address all needed repairs and nicely renovate their home. Buyer used the SOR to get bids from general contractors. After reviewing contractor bids with their Renovation Consultant, they settled on a contractor whose Bid on Repair (BOR) was for $190,000.*

Using the SOR, appraiser "Joe" determines a Value After Renovation (VAR) of $250,000 or more for "Property A." The CRP lender approves a mortgage based on that $250,000 appraised VAR and gives buyer a loan based on the $50,0000 Purchase and Contractor bid of $190,000 for a loan based on the total cost (purchase and renovation) of $240,000. HUD insures the mortgage for $240,000. When the loan closes, the contractor begins work. Three months later, the CRP lender verifies through the renovation consultant that work is complete and satisfactory per the Specification of Repairs.

Four months later: Coincidently, appraiser Joe is hired to appraise a comparable home right next door, ***"Property B"****. Property B is a grossly inefficient home in need of major repairs. The owner has a mortgage of $120,000, but the home is only worth $80,000. The owner qualifies for a CRP refinance via Fannie Mae Homestyle® for up to $250,000. The owner hires a Renovation Consultant who provided a Specification of Repairs (SOR) for $100,000 to address all needed repairs and nicely renovate their home. Owner used the SOR to get bids from general contractors. After reviewing contractor bids with their Renovation Consultant, they settled on a contractor whose Bid on Repair (BOR) was for $95,000.*

[5] http://www.merriam-webster.com/dictionary/sale

$120,000 mortgage balance
+ $ 95,000 renovation cost
$215,000 new loan amount
($250,000) appraised VAR

$ 15,000 additional equity

Appraiser Joe uses the Bid on Repair (BOR) to appraise Property B. Unfortunately, Joe is forced to use the $50,000 sales price of property A as a comparable (because that is what is recorded as a sale and the nearby comparables initially used to appraise property A had expired). Appraiser Joe is not allowed to consider the $250,000 appraised VAR of property A, because guidelines exclude VAR from useable comparables.

End result: *Property B depreciates in value simply because Property A was purchased and renovated by a consumer using a HUD insured loan, as opposed to remodeled by real estate investor and sold at the VAR price for $250,000 or more, creating the sale. The difference is only fundamental, yet tremendously impacts property value negatively.* ***The government, is in fact, insuring a mortgage based on a $250,000 appraised VAR, yet, for all other purposes, still shows a distressed value of $50,000 on public record and the MLS.*** *In addition, the homeowner of Property A unknowingly contributes to the de-valuation of area properties while simultaneously making a home purchase and renovation that far exceeds its systematically recognized value.*

As it is today, the owner of property B may be forced to pursue a loan modification, short sale, or foreclosure. This example brings to question:

Should CRP/VAR be recognized as a comparable?

If the guidelines were updated to allow CRPs to be the exception to the "sales" rule, HUD's CRP would support its mission of "community and neighborhood revitalization" (below):

> *The Section 203(k) program is FHA's primary program for the rehabilitation and repair of single family properties. As such, it is an important tool for community and neighborhood revitalization, as well as to expand homeownership opportunities.*[6]

What if CRP/VAR were comparables?

The original CRP value, as it was appraised, would be utilized as a tangible comparable when the work is complete. This provides a more accurate representation of property values.

Neighborhood Stabilization Programs will be substantially more effective when combined with CRPs as comparables, particularly in underserved communities. If residents were made aware of how CRPs work and when a new higher value comp from NSP, non-for-profit or an investor flip is in their area, many would recognize that as their market recovered, and tap into those

[6] http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/203k

values with renovations of their own. Increasing consumer awareness of CRPs substantially benefits neighborhood revitalization.

Just as consumers in need of options were educated on the existence of loan modifications, the same or better education and outreach should be applied for consumer renovation programs. Many homeowners would likely have chosen a CRP and updated their home over a loan modification, if only they *knew* about it.

Television shows, such as Home and Garden Television's *(HGTV's) Love It or List It*, *Property Brothers*, and *Fixer-Upper,* among others, inspire millions of consumers to consider home renovation and repair. If CRPs were general knowledge, home buyers and existing home owners would see them as the means (funds) to make *real* the notion of an updated, more comfortable and efficient home.

With consumer renovation programs as comparables, coupled with general awareness of their benefits, millions of consumers will have access to affordable renovation funds, playing an active role in neighborhood revitalization.

Each time used, CRPs could:

- Create a higher value comparable and be the fuel to keep the property value engine running;
- Reduce the number of existing homesteads in disrepair and overall distress;
- Create jobs to meet the demand for needed carpenters, electricians, plumbers, etc;
- Increase sales of home centric manufactured products to support renovation. Consumer spending will also increase appropriately, for new furniture, appliances, etc; and
- Support the Community Reinvestment Act for originating banks through the direct impact on neighborhood and community revitalization.

If a bill were needed to make CRPs comparables, it would be favored as a non-partisan *solution* where the average consumer benefits and the banks profit. It could also be viewed as a correction and potentially be a simple administrative adjustment.

With CRPs as comparables, long sought-after partnerships between the public and private sectors are created, promoting neighborhood revitalization focused on the homestead, using funds from the private sector banks.

Proposed Course of Action:

1. **AWARNESS –** Educate consumers on CRPs and their benefits, including but not limited to government (national, state, local), housing advocates and related non-for-profits, mortgage lenders, real estate associations, etc. This is the one of primary goals of The Village Network (TVN).
2. Have data listing aggregators (i.e., MRED) add one new field, "Value After Renovation" (VAR), to MLS for CRPs to be located below "Sold Price" field.
3. Update Fannie Mae & HUD/FHA guidelines to allow appraisers to use VAR as a comparable for owner-occupied properties.

4. Determine a process to populate this new field for purchases and refinances, which may include the following:

   Purchases

   - Have borrower sign a release of appraised value at closing;
   - Add $250 to borrowers closing costs to allow appraiser to re-certify appraisal and make adjustments for cases where the SOR has changed.
   - MLS Update after appraiser re-certification:
     1. Originating lender to provide appraised VAR or adjusted appraised VAR to listing agent on purchase.
     2. Originating lender to provide description of finished product, i.e., additional bathrooms, bedrooms, finished basement, stainless steel appliances, etc.

   Refinances

   Refinances, though not recognized as a purchase or sale could still be the exception due to the tangible improvements to the property. The strong recommendation would be that at least one sale would be required among the utilized comparables for the assurance of existing market factors.

   - Have borrower sign a release of appraised value at closing;
   - Add a $250 re-certification fee to borrowers closing costs for allowance of appraiser to make adjustments if the SOR has changed; and
   - Update MLS after appraiser re-certification, to include room additions, finished basements, new garage, etc.

The VAR initiative is a viable solution—an opportunity that forges a win-win partnership between the government and the private sector. VAR will stimulate neighborhood revitalization and economic development through fair market value recovery of existing homesteads in distress, as well as create training, education and jobs to meet the demand for carpenters, electricians, plumbers, etc. That's just the beginning of a list of major benefits.

The Village Network, NFP is a 501-c(3) organization with the mission of community and neighborhood revitalization through consumer education and economic empowerment.

The Village Network
Neighborhood Revitalization from Within

8708 S. Bennett Ave, Ste 123
Chicago, IL 60617
LiveNChicago@gmail.com
www.villagenetwork.org
773-426-2896

Glossary of Terms

Comp: Comparable property (**comp**) is a property that is within a determined radius or area, with similar or comparable features, size, and condition of a property that is being appraised. The sold price (sold in 12 months or less) of the comp selected is compared to the subject property to determine an opinion of its value (appraised value).

CRP: Consumer Renovation Program (**CRP**) refers to a mortgage obtained by a consumer that includes the financing to repair or remodel the home.

Fannie Mae: The Federal National Mortgage Association (**FNMA**), usually known as Fannie Mae, is a government-sponsored enterprise that buys loans from mortgage lenders, packages them together, and sells them as a mortgage-backed security to investors on the open market.

Fannie Mae Home Style® Renovation mortgage that permits borrowers to include financing for home improvements in a purchase or re-finance transaction of an existing home.

FHA: The Federal Housing Administration (**FHA**) is a United States government agency created as part of the National Housing Act of 1934. It sets standards for construction and underwriting and insures loans made by banks and other private lenders for home building.

FHA 203(k): Section 203(k) insurance enables homebuyers and homeowners to finance both the purchase (or refinancing) of a house and the cost of its rehabilitation through a single mortgage or to finance the rehabilitation of their existing home.[7]

HUD: The United States Department of Housing and Urban Development (**HUD**) is a Cabinet department in the Executive branch of the United States federal government.

MLS: Multiple Listing Service (**MLS**) is a private offer of cooperation and compensation by listing brokers to other real estate brokers. MLSs are private databases that are created, maintained and paid for by real estate professionals to help their clients buy and sell property.[8] Various real estate professionals may subscribe to the MLS, including appraisers, who use historical sales data of comparables (comps) reported on the MLS to determine an opinion of value of properties being appraised.

Mortgage Insurance: A policy that protects lenders against losses that result from defaults on home mortgages. The premium us paid by the homeowner.

Renovation Consultant: Certified by HUD as a 203(k) inspector, a renovation consultant is a contractor or inspector who performs site visits, writes up a specification of repairs (SOR), and performs draw request inspections to assure that work is complete and acceptable to the homeowner and lender.

Specification of Repairs: Specification of repairs (**SOR**) is a report drafted by a renovation consultant to document the detailed labor and material costs of renovation. This SOR is followed by the contractor who completes the repairs/remodel.

VAR: Value After Renovation (**VAR**) is the appraised value of a property after repairs and renovation has been completed.

---

[7] http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/203k/203k--df
[8] http://www.realtor.org/topics/nar-doj-settlement/multiple-listing-service-mls-what-is-it